

**TESTIMONY OF
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U.S. SECURITIES AND EXCHANGE COMMISSION**

**CONCERNING LEGISLATIVE SOLUTIONS TO PROBLEMS
RAISED BY EVENTS RELATING TO ENRON CORPORATION**

**BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SUPONSORED ENTERPRISES**

UNITED STATES HOUSE OF REPRESENTATIVES

February 4, 2002

Chairman Baker, Congressman Kanjorski, Members of the Subcommittee:

I am pleased to appear before you on behalf of the Securities and Exchange Commission to testify about possible legislative solutions to problems raised by events relating to Enron Corporation. I would like to commend Chairman Baker and the Committee for convening these hearings. They are a timely and appropriate way for all of us to reflect on one of America's worst business failures.

The Enron debacle is tragic, and many Americans have felt its consequences. Innocent investors were betrayed by abuses of our system of disclosure and accounting. Most tragic are investors who entrusted some portion of their life savings to a company that purported to be profitable, placing their confidence in the company, its auditors, research analysts, rating agencies and our federally mandated disclosure system. Equally betrayed are those who held Enron stock in their retirement accounts and made life-altering decisions based upon the stock's perceived value, only to find themselves locked in to a rapidly sinking investment that ate up years of hard work. It is these Americans, whose faith fuels our markets, who have no lobby and no trade associations, whose interests are, and must be, paramount. I am appalled at what happened to them as a result of Enron's collapse. The Commission as an institution, and I both as its Chairman and personally, are committed to doing everything in our power to prevent other abuses of our system like Enron from happening again.

The SEC's primary responsibilities are to protect public investors and to promote the fairness, effectiveness and efficiency of our capital markets. In the face of Enron's meltdown and tragic consequences, our agency currently is conducting an enforcement investigation to identify violations of the federal securities laws that may have occurred, and those who perpetrated them. When Enron began to implode, my fellow Commissioners and I immediately – and unanimously – ordered a no-holds barred investigation, which is still underway. Until the investigation is complete, we cannot fairly assign blame for past events. The public can have full confidence, however, that

our Division of Enforcement will conduct a thorough investigation and that the SEC will redress any and all wrongdoing and wrongdoers swiftly and completely.

Congress wisely permeated the federal securities laws with a philosophy that investors must be fully informed and confident that our markets are free from fraudulent, deceptive and manipulative conduct. We are tasked with defining and enforcing these laws; Congress already has given us enormous power to do so. Anyone who violated the laws we enforce will be held fully accountable. Moreover, we are assisting the criminal authorities and the Department of Labor in every way possible in enforcing the laws they administer. We are doing our utmost to get to the bottom of this disaster and ensure that all who are responsible for this outrage get all they deserve.

Even prior to Enron, we had been working to improve and modernize our corporate disclosure and financial reporting system, to make disclosures and financial reports more meaningful and intelligible to average investors. Investors are entitled to the best regulatory system possible. To reassure investors and restore their confidence, we must address flaws in our current disclosure and accounting systems that have languished too long.

Who should address these flaws? At the dawn of a new century, let us reflect a moment on the wisdom of America's leaders a century ago. Teddy Roosevelt confronted the power of business, at that time in the form of vast "trusts," and asked the fundamental question – was government capable of policing business where the public interest requires? Many today are again asking the same question – is government capable of policing business where the public interest requires? The clear answer is, and must always be, yes. The federal government, and in particular the SEC, can and will police business. My fellow Commissioners and I guarantee that. Enron changes how citizens look at the safety of the markets, the truth of corporate disclosures, the dependability of financial statements, the validity of analyst recommendations, and the reliability of rating agency evaluations. I am committed, and the Commission is committed, to reexamining every assumption, every rule and regulation, in light of Enron. There are fundamental, longstanding flaws in our system – and now they are on the table. I do not know, and do not have for you today, the final answers. But, at the end of the process we will have a better system of corporate disclosure.

We already have been working with Congress, the Justice Department, the Labor Department, and the President's Working Group on Financial Markets. The SEC does not have a monopoly on wisdom nor do we have definitive answers to the problem. What we do have is an undeniable obligation to think about the issues, search for answers, lead constructive debate, and to move quickly on behalf of investors to try to prevent future Enrons.

In his State of the Union Address, the President appropriately demanded "stricter accounting standards and tougher disclosure requirements." He wants corporate America to "be made more accountable to employees and shareholders and held to the highest standard of conduct." The SEC shares and embraces these principles, and we are firmly

committed to making them a reality. We are working on many initiatives for improving and modernizing the current disclosure and regulatory systems. These initiatives include, but are not limited to, the following:

- A system of “current” disclosure. Investors need current information, not just periodic disclosures, along with clear requirements for public companies to make affirmative disclosures of, and to provide updates to, unquestionably material information in real time.
- Public company disclosure of significant current “trend” and “evaluative” data. Providing current trend and evaluative data, as well as historical information, would enable investors to assess a company’s financial posture as it evolves and changes. It would also preclude “wooden” approaches to disclosure, and encourage evaluative disclosures that begin where line item and GAAP disclosures end. This information, upon which corporate executives and bankers already base critical decisions, can be presented without confusing or misleading investors, prejudicing legitimate corporate interests or exposing companies to unfair assertions of liability.
- An updated and improved system of periodic disclosure. In addition to the new disclosure regime we believe investors deserve, we intend to keep, but improve, the existing periodic disclosure system. Quarterly and annual reports can be produced more quickly, and can be more comprehensible than they presently are, appropriately reflecting risks and returns. We intend to make them so.
- Financial statements that are clear and informative. Investors, and employees concerned with preserving and increasing their savings and retirement funds, deserve comprehensive financial reports they can easily and quickly interpret and understand.
- Conscientious identification and assessment by public companies and their auditors of critical accounting principles. Public companies and their advisers should be required to identify the three, four or five most critical accounting principles upon which a company’s financial status depends, and which involve the most complex, subjective, or ambiguous decisions and/or assessments. Investors should be told, concisely and clearly, how these principles are applied, as well as information about the range of possible effects in differing applications of these principles.
- Accounting standard setting that responds expeditiously, concisely, and clearly, to current and immediate needs and reflects business realities. Improved standard setting is a high priority. The FASB, the private standard setting board for accounting principles, is the appropriate place for resolving debate on technical issues. But it must act. For too many years the FASB has failed to set standards for accounting for special purpose entities. In the wake of Enron, it must act and act quickly to give guidance.

- An effective and transparent system of private regulation of the accounting profession, subject to our rigorous oversight. We recently initiated discussion of how best to restructure the regulatory system governing the accounting profession. We suggested creating a new Public Accountability Board to assume responsibility for auditor and accountant discipline and quality control. At least a predominant majority of the members of the new disciplinary body we envision must be unaffiliated with the accounting profession. Our proposed oversight body would be funded not by the accounting profession but from the entire private sector, giving no group the ability to dictate, control or influence their decisions and efforts.
- A system that ensures that those entrusted with the important public responsibility of performing audits of public companies, are single-minded in their devotion to the public interest, and are not subject to conflicts that might confuse or divert them from their efforts. Those who perform audits must be truly independent and in particular must not be subject to the conflict of increasing their own compensation at the risk of ensuring the public's protection. Their fidelity to the cause of full, fair and understandable financial reporting must be ironclad and unequivocal.
- More meaningful investor protection by audit committees. Audit Committees must be proactive, not merely reactive, to ensure the quality and integrity of corporate financial reports. Especially critical is the need to improve interaction between audit committee members and senior management and outside auditors. Audit Committees must understand what and why critical accounting principles were chosen, how they were applied, and have a basis for believing the end result fairly presents their company's actual status.
- Analyst recommendations predicated on financial data they have deciphered and interpreted. This Subcommittee, through Chairman Baker and Congressman Kanjorski, and the full Committee, led by Chairman Oxley and Congressman LaFalce, have led the way in bringing attention to shortcomings in the conduct of Wall Street analysts. We see these shortcomings again in the Enron situation. Changes here are long overdue. Working with the Congress and the securities industry, we are on the threshold of new rules that will create more transparency for analyst recommendations.

These are just some of the initiatives we are considering and solutions we are proposing for consideration. We are committed to making disclosures more meaningful, and intelligible, to average investors. We are soliciting broad input. The Commission will hold its first ever "Investor Summit" this May, to solicit investor input on the policy issues that confront us as we begin reforming our disclosure and financial reporting process. We are also planning to hold a series of Roundtables to discuss significant issues regarding our ideas for reform and the suggestions of others. It is incumbent on the SEC to consider the issues, put forward the most responsible proposal it can, and

engage in dialogue with all parties willing to participate. That is the process we have begun, and I can assure you we are committed to following through promptly on this process by taking all steps necessary to reassure the public and preserve confidence in our disclosure and financial reporting process.

We have the requisite authority to enforce the federal securities laws vigorously. We also believe we already have statutory authority to adopt rules that would implement the important improvements that I just mentioned, as well as others necessary to address the problems in our system brought to light so vividly by the collapse of Enron. By the same token, if major and sweeping changes are to be made, even by rulemaking, Congress should, and must, be an active participant in the process. Congress is the body of government most directly accountable to the people. We intend to work closely with you to ensure that the regulatory framework we ultimately propose meets your view of what is appropriate and in the interests of the public.

It is Congress, however, that must make the final judgment whether legislation is necessary or appropriate. As I have said before, we will work, and indeed are already working, with Members on both sides of the aisle, in both the House and the Senate, regarding legislation Congress may consider. We will continue in these efforts and are committed to implementing any legislative changes Congress ultimately believes are necessary. In our view, any such changes should include provisions broadly reaffirming and enabling the SEC to improve the current disclosure and accounting system.

One area of possible legislation already identified is the need to require corporate insiders to make public their trading activities more quickly than current law requires. Under current law, which dates back to 1934, the principal provision covering reporting by insiders calls for filing by the tenth day of the month after the month when the trading occurred. That may have been good enough in 1934, but it is not nearly good enough today.

Our system must be improved and modernized. We are up to the task, but only if we are able to tap our best minds to produce our most creative solutions, and only if we are able to discuss these issues openly, honestly, and as constructively as possible. The SEC is committed to that end, and we seek participation by everyone with an interest in our capital markets. Together, we can, we must and we will make a difference. That is our vision and our unalterable mission.

On behalf of the Commission, I appreciate the opportunity to submit our views on legislative solutions. I am happy to try to respond to any questions the Subcommittee may have.